

Sara Neely and Elizabeth Moxham

Federal Budget Eliminates Capital Gains Tax on Gifts of Securities



// Charities now have a powerful set of tools for raising the funds they need to meet the needs of Canadians."

Federal Budget, May 2, 2006

Almost 10 years in the making, those words were cause for celebration for many practitioners in the voluntary and not-for-profit sector *and* for the many individuals across Canada who hold stocks in their financial portfolios. The Federal Budget 2006 announced the complete exemption from capital gains tax on gifts of publicly traded securities to public charities and public foundations.

This single initiative has the power to transform our communities and the lives of the people who live in them. Through the additional resources that can now be unleashed from unrealized capital gains held in stock portfolios, donors have a more cost-effective way to support the thousands of charitable organizations that provide vital programs and services to all Canadians.

The not-for-profit sector affects almost every part of our lives. Every day, people are assisted through the delivery of services such as education, social services, health, disaster relief, and community development.

Lives are enriched through the delivery of programs in areas such as religion, sports, arts and culture, and environmental protection.

The majority of Canadians—almost 95 percent—believe charities are becoming increasingly important to Canadians. More than 70 percent of Canadians believe that charities understand the needs of the average Canadian better than government and do a better job than government in meeting those needs.

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Canadians want to contribute to these organizations in a meaningful way. Research and anecdotal evidence shows that people generally give because they want to give; they believe in the charitable cause and they want to make a difference. As the size of the gift increases, however, so does the impact of tax incentives for the donor. And now, more than ever, it is more cost effective to make a gift of securities than a gift of cash.

It is important to note that the tax incentives for giving apply only to not-for-profit organizations that are registered charities. Furthermore, the

elimination of tax on gifts of publicly traded securities applies only where the securities are given to public charities or public foundations. The measure has not been extended to gifts of publicly traded securities to private foundations, although the government is reviewing this.

Some Background

To understand the impact of this initiative, it is important to understand its roots.

Beginning in 1997, individuals and corporations donating publicly traded securities to public charities were required to include in income, for tax purposes, only *one-half* the amount of the capital gains realized on the donation as compared to other capital gains.

Publicly traded securities are all securities listed or posted for trading on Canadian and major international exchanges. Securities include stocks, trust units, mutual fund units, and bonds.

- If a donor owned publicly traded securities that increased in value and decided to **sell** them, 50 percent of the capital gain was taxable.
- If the donor **donated** those securities to a public charity or public foundation prior to the Federal Budget of May 2, 2006, only 25 percent of the capital gain was taxable.

The resulting tax credit from the donation of the securities not only offset the tax on the capital gain, it helped reduce other taxes payable on other income. For the tax incentive to apply, the securities must be transferred “in kind” to the charity, not in the form of cash proceeds from the sale of the securities.

- As of May 2, 2006, when publicly traded securities are donated to public charities or public foundations, the entire capital gain is exempt from tax.

While practically, this change is merely incremental to the initial reduction on capital gains tax on donations of securities introduced by the government in 1997, the psychological impact of complete elimination of the tax on these donations is monumental.

Although this new incentive has not yet been enacted into law, it is common practice for taxpayers to take steps in reliance that it will be enacted with retroactive effect. Since all federal political parties campaigned to implement this measure in the last federal election, it is extremely likely that this will be enacted.

Tax Incentive Translates to More Gifts for the Charitable Sector

From 1997 to 2000, gifts of publicly traded securities to public charities in Canada soared from \$69 million to \$200 million. With a much more modest rise in overall gifts, the share of securities in total donations rose from 1.6 to 3.9 percent. According to a recent report from TD Bank Financial Group¹, the \$200 million of security gifts pales against the \$1.3 trillion market value of stocks held by Canadians.

Unrealized capital gains account for almost half of these holdings. Exempting capital gains from taxation should unlock more of these holdings and cause a further shift in the distribution of donations away from cash toward stocks.

1 Don Drummond, Senior Vice President and Chief Economist, *TD Economics Special Report*, February 8, 2006

TAX ASSISTANCE FOR CHARITABLE DONATIONS BY INDIVIDUALS of Cash compared to Donations of Publicly Traded Securities			
	METHOD OF DONATION		
	Donation of Cash	Securities Donated to BC Children's Hospital Foundation	
		Pre-Budget 2006 <i>(25% inclusion rate on capital gains)</i>	Budget 2006 <i>(0% inclusion rate on capital gains)</i>
Donation Amount (Fair Market Value)	\$1000	\$1000	\$1000
Charitable Donation Tax Credit Received (43.7% in BC at top marginal rate) (A)	\$437	\$437	\$437
Typical Cost Base (ACB) of security	n/a	\$400	\$400
Capital Gain on security (FMV-ACB)		\$600	\$600
Capital Gain tax owing if security sold, not donated (50% inclusion rate)		\$130	\$130
Tax saved due to incentive (B)		\$65	\$130
Total tax assistance (A+B)	\$437 (44%)	\$502 (50%)	\$567 (57%)
Net Cost of Donation to Donor	\$563 (56%)	\$498 (50%)	\$433 (43%)

The impact of the Federal Budget 2006

The above table shows the impact to the donor of the incentive introduced in the 2006 budget. When publicly traded securities are donated to a public charity or public foundation, as of May 2, 2006, there will be no tax payable on the capital gain.

The donor will receive a donation receipt for the fair market value of the publicly traded securities—the closing price on the day they are transferred into the charity's brokerage account. The resulting tax credit can be used to offset taxes payable on up to 75 percent of the donor's net income in the year of the gift. Any excess tax credit can be used to offset income in the following 5 years.

This example illustrates the following points.

1. For a **cash** donation in British Columbia, the donor bears 56

percent of the cost of the gift.

2. Under the pre-Federal Budget 2006 regime, the donor's contribution for a gift of publicly traded securities was 50 percent.
3. Effective May 2, 2006, the donor's contribution for a gift of publicly traded securities is 43 percent.

It is significant that the elimination of capital gains tax on donations of securities provides donors with two types of tax savings:

- a tax credit of 43.7 percent, and
- an additional tax savings of 8 to 15 percent, depending on the cost base of the securities (and tax savings of up to 22 percent, if the cost base is zero).

It is simply more cost effective to donate securities rather than cash. In fact, in this example, the

donor actually makes money on the gift, relative to the amount originally invested. The original investment was \$400, but the donor ends up with a \$437 tax credit and total assistance of \$567. The lower the cost base, the higher the benefit to the donor.

While many factors influence the donation of publicly traded securities, it was estimated in the Federal Budget that the elimination of the capital gains tax on these donations may support about \$300 million in annual donations across Canada. Experts in the charitable sector believe the impact will be much higher.

Making the Gift

Making a gift of publicly traded securities to a public charity is easy to do. Securities can be electronically transferred to the charity from the donor's own brokerage account or they can be in the form of a share certificate in the donor's name, which is delivered to the charity.

At BC Children's Hospital Foundation, for example, we work with the donor and his or her advisors to ensure the transfer is smooth and the donation receipt is delivered to the donor. We also provide a sample letter of instruction to the donor's broker to facilitate the process. It is as easy as writing a cheque.

Donors may wish to use this new incentive to combine charitable giving with cash planning. Using a "50/50" donation plan enables a person to make a charitable gift and keep cash in hand for personal use. Simply donate 50 percent of the stock and sell 50 percent of the stock.

Using the example above, the donor would make a \$500 gift to charity, would pay \$65 in tax but receive a \$217 tax credit, for a net tax credit of \$152—and would have net cash in his pocket of \$652.

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A Tool Box, Indeed

There have been many favourable changes to the *Income Tax Act* in the last decade, including the increase in the annual donation limit to 75 percent of income for lifetime gifts and 100 percent of income for gifts on death and the direct designation of gifts of life insurance, RRSPs, and RRIFs to charities and the resulting donation receipt to the estate.

With the complete elimination of tax on gifts of publicly traded securities to public charities and public foundations, these organizations do indeed have a powerful set of tools for raising the funds they need to meet the needs of Canadians. ▲

Sara Neely, LL.B., CFRE, is Director of Gift and Estate Planning for BC Children's Hospital Foundation and a member of the Canadian Bar Association Wills and Trusts subsection, the Estate Planning Council of Victoria, and the Canadian Association of Gift Planners. Based in the foundation's Victoria office, Sara works with Elizabeth and other colleagues in the foundation's Vancouver office to serve donors and their advisors across BC.

Voice: 604 628-0227,
(toll free from Lower Mainland)
250 483-4349 (Victoria area)
sneely@cw.bc.ca

Elizabeth Moxham, LL.M., is Senior Development Officer for BC Children's Hospital Foundation and a member of the Canadian Bar Association, the Canadian Association of Gift Planners, and the Editorial Advisory Board of Gift Planning in Canada.

Voice: 604 875-2345, ext. 5402
emoxham@cw.bc.ca
www.bcchf.ca